

HORIZON

trends and issues to watch, ideas and innovations to use

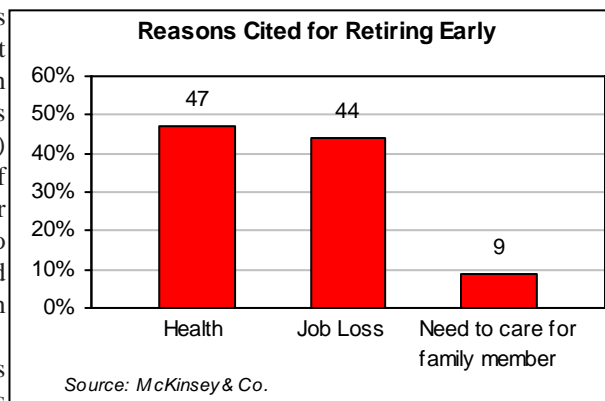
Retirement Picture Changing

About half of American retirees quit working sooner than planned, usually because of health problems or layoffs, according to a May 2006 *Los Angeles Times* article.¹ While 40 percent retired earlier than expected, just 13 percent of retirees worked past age 65 compared with 45 percent of current employees who say they plan to do so. As more companies default on pension and health insurance provisions, many would-be retirees find they need earnings and/or benefits to bolster their retirement savings. Those who retired earlier than they had hoped cited health reasons, job loss, or the need to care for a family member.

American retirees from the “Big Three” Japanese auto companies—Toyota, Honda, and Nissan—have an entirely different pension agreement than peer retirees from the American “Big Three”—Chrysler, Ford, and General Motors (GM), *The New York Times* reports.² Japanese companies structure benefit packages so that retirees shoulder a much bigger portion of their retirement costs and risks. At Toyota, retirees have an investment account in which the company deposits 5 percent of the worker’s earnings each year. Farsighted workers can supplement that with a 401(k) plan, which the company will match up to a set maximum. Instead of a defined monthly pension check, the retiree is dependent on their contributions and the financial markets. At age 65, retirees are no longer covered by the company health plan. Instead, they are paid a lump sum to buy a Medicare supplement. Toyota’s 2006 pension benefits are expected to cost less than a tenth of GM projections.

Of the major Japanese automakers, only Honda still guarantees pensions for their American retirees. Retirees of American automakers receive monthly pension checks, and most of their health expenses are covered. But in a short 15-year span, from 1990 to 2005, GM’s workforce shriveled to one third its former size. Now retirees and their dependents outnumber current workers three to one. GM’s unfunded liability of \$85 billion for future health care costs for workers and retirees is at least seven times the company’s market value. GM estimates that each of their American-made vehicles costs an added \$1,500 to make due to health care costs alone. Chrysler estimates their health care costs at \$1,400, and Ford claims their cost is \$1,100.

Possible Implications for Kentucky: Free health care and defined pensions were the norm in retirement packages planned in the mid-20th century. Offering generous retirement benefits seemed less expensive at the time than paying higher wages. Today, defined benefit pension plans are fast being replaced by defined contribution plans throughout the private sector, making retirement income dependent on the structure of the plan, the investment acumen of workers, and the health of financial markets. At the same time, workers are shouldering more, if not all, of their own health care costs. A Kaiser Family Foundation survey finds that only a third of big companies now offer their retirees health care coverage, half the number that did so in 1988. Already ill-prepared for retirement based on 2000 findings from a statewide survey by our Center, even Kentuckians who thought they were prepared are seeing promised benefits disappear, as companies jettison long-term financial obligations. Ultimately, underfunded pension and health care provisions combined with rising living costs could force more elders into poverty and create higher rates of dependency. In 2005, Kentucky ranked fifth in the nation in elder poverty, a circumstance that compels the attention of policymakers here and at the national level.



Deficits, Entitlements Threaten Nation’s Fiscal Future

The economic future of our nation is in danger, and Washington’s leadership must do something about it, asserts Comptroller General David M. Walker,³ the nation’s chief accountability officer. The U.S. economic model is unsustainable, according to Walker. To avoid federal bankruptcy, deficit spending and fiscal woes with Medicare, Medicaid, and Social Security must be

KENTUCKY LONG-TERM POLICY RESEARCH CENTER

111 St. James Ct.
Frankfort, KY 40601
502-564-2851 or 800-853-2851
www.kltprc.net

2006 BOARD OF DIRECTORS

Chair *Brian Van Horn* Vice Chair *Brad Cowgill*

Legislative Branch *Sen. Walter Blevins, Sen. Tom Buford, Sen. Alice Forgy Kerr, Rep. Reginald Meeks, Rep. Stephen Nunn*

Executive Branch *J. Andrew Hightower, Mary E. Lassiter*

At-Large Members *Ron Carson, Paul B. Cook, Betty Griffin, Daniel Hall, Jeff Jobe, Jennifer M. Keach, J. Brent Legg, Robert Sexton*

EXECUTIVE DIRECTOR *Michael T. Childress*

CONTRIBUTING WRITERS *Billie S. Dunavent, Mark Schirmer, Michal Smith-Mello*

addressed. Mr. Walker claims that major changes to these programs as well as additional tax revenues are needed to stave off impending disaster. The nation's debt—roughly \$411,000 per household—will only multiply as retiring baby boomers add further strain to entitlement programs, particularly Medicare.


Public sector pension plans, *The New York Times* reports, also face billions in shortages⁴ and threaten the fiscal health of governments at every level. Nationwide, a number of states, counties, and municipalities have been shortchanging their pension funds for years, though the true extent of the damage remains unknown. No central regulator gathers data on public plans and accounting for government pension plans is not uniform. But estimates of what state and local governments owe current and future retirees run as high as \$2.5 trillion, while only \$1.7 trillion has been put aside to pay for these benefits. Unlike banks and insurance companies, public pension plans, though large and complex financial institutions, do not face comparable systems of checks and balances.

Possible Implications for Kentucky: Economists from both political parties agree that long-term forecasts show the system as it stands must be changed to avoid a potential fiscal disaster due to deficit spending, costly entitlement programs, and insufficient revenues. Rather than awaiting a financial catastrophe to befall the country, Walker and others are urging policymakers to take proactive steps now. Growing global government deficits could threaten financial systems worldwide and impair our nation's ability to grow. As baby boomers enter retirement and gradually reach old age, social programs could place severe strain on budgets at every level and exacerbate shortfalls in public finances. Without attention to the management of underlying costs, the obligations of Medicare alone could skyrocket. Changing demographics pose tremendous challenges for political leaders struggling to steer the budgeting process, but as Walker warns, they demand attention now. All states and all citizens, particularly disproportionately poor ones like ours, will suffer in the event of federal bankruptcy.

Concern Over Rising Health Care Costs Deepens

Rising employee health costs are the biggest concern and the main obstacle blocking expansion for small businesses, USA Today reports.⁵ Business owners desperate for relief from health care costs are turning to customized health plans, “wellness” programs, health savings accounts, and cooperative efforts with other small firms to earn discounted rates and lower costs. But small businesses are not alone. A recent survey commissioned by PNC Financial Services Group reports that one third of higher-income U.S. adults—those with a minimum annual income of \$150,000 and at least \$500,000 in investable assets, such as real estate, stocks, and bonds, and retirees with at least \$1 million in assets—worry that health care costs will absorb a significant percentage of their financial assets.⁶ Among those aged 45 to 64, 43 percent have such concerns. A large portion (42 percent) of survey respondents express doubt about the long-term solvency of Medicare. More than half of those who are parents did not think Medicare will be available for their children. Regarding long-term care insurance, a fourth of respondents worried that their parents did not have such coverage; nearly a third had purchased it for themselves.

Business Week reports that Amy N. Finkelstein, an economics professor at the Massachusetts Institute of Technology (MIT), concludes that the real reason for the rapidly rising cost of health care is the massive 40-year expansion of medical insurance.⁷ Though new technologies play an integral part in rising health care costs, the MIT economist believes that doctors, hospitals, and consumers adopt new technologies so freely and patients opt for more care largely because insurance pays for it. Moreover, she argues, insurance assures hospitals and other health providers a steady source of revenue, allowing them to regularly build new specialty centers and purchase the latest high-tech equipment. However, Ms. Finkelstein's theories have not garnered universal acceptance. Critics claim she has overstated the influence of insurance on health costs, while others have questioned whether her theory holds equally true for private coverage as well as government-run programs like Medicare, which has much lower administrative costs. Too, one question remains unanswered: has the ballooning spending for health care seen over the last 40 years resulted in a higher quality of care?

Possible Implications for Kentucky: As health insurance costs spiral out of control, many of the nearly 90,000 small firms that employ 50 or fewer people in Kentucky have seen the cost of health insurance for their employees gradually exceed their reach. In 2005, just 43 percent of these firms offered their employees access to health insurance. When asked why not, 37 percent said they had tried to buy insurance but it was too expensive. The Fletcher administration's ICare Program, which was adopted by the General Assembly in 2006, will provide these struggling small firms with subsidies for coverage costs. Whether they will be adequate in the face of steadily increasing health insurance costs is yet to be seen. In any event, the program's promise and progress should be closely monitored as we seek solutions to a growing uninsured population. 

Sources

¹ Jonathan Peterson, “Many Forced to Retire Early,” *Los Angeles Times* 15 May 2006.

² Eduardo Porter, “Japanese Cars, American Retirees,” *The New York Times* 19 May 2006.

³ Brad Schrade, “Economist says deficit big threat,” *Tennessean* 19 August 2006.

⁴ Mary Williams Walsh, “Public Pension Plans Face Billions in Shortages,” *The New York Times* 8 August 2006.

⁵ Jim Hopkins, “Putting a Band-Aid on Small Firms' Health Costs,” *USA Today* 19 April 2006.

⁶ The Henry J. Kaiser Family Foundation, “Many Higher-Income U.S. Adults Concerned About Health Care Costs, Survey Finds,” *Kaiser Daily Health Policy Report* 11 April 2006.

⁷ Howard Gleckman, “So That's Why It's So Expensive,” *Business Week* 14 August 2006.